American Federation of Labor and Congress of Industrial Organizations

815 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 637-5000
www.aflcio.org

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October 6, 2008

Sent by E-Mail to e-ORI@dol.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Investment Advice Regulation and Class Exemption
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington DC 20210

Re: Investment Advice Provided to Participants and Self-Directed Individual Account Plans—Proposed Regulations and Class Exemption

Ladies and Gentlemen:

On behalf of the more than 10 million working men and women of the AFL-CIO, we offer our comments on the proposed regulations implementing the statutory exemption on investment advice under Sections 408(b)(14) and 408(g) of the Employee Retirement Income Security Act of 1974, as amended (ERISA)[1] and the proposed class exemption for the provision of investment advice.[2]

Over the past twenty years, the number of employer-provided individual account plans, primarily plans providing workers the opportunity for pre-tax savings under Section 401(k) of the Internal Revenue Code of 1986, as amended, has exploded—from almost 30,000 in 1985 to 436,000 in 2005.[3] Worker savings in individual account plans can and should be an important

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1 The new statutory exemption was added by Section 601 of the Pension Protection Act of 2006, Public Law 109-280, 120 Stat. 780 (Aug. 17, 2006).

2 The proposed regulation and the proposed class exemption were both published in the Federal Register on August 22, 2008.

3 The most recent available data is for 2005. *See* U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin Historical Tables* (February 2008).

component in assuring retirement income security, but they should not serve as the primary source of retirement income. Instead, they should supplement Social Security and traditional employer-funded defined benefit pension plans, each of which guarantee lifetime retirement income to workers and their families. Individual account plans pose substantial, well-recognized risks to workers and—standing alone—they generally do not assure true retirement security. Under these plans, the risks of investment, adequacy and longevity are borne by the workers—increasing the likelihood there will be inadequate assets upon retirement to provide a sufficient stream of income.

Because most individual account savings plans require participating workers to make their own investment decisions, we agree with Congress and the Department that professional investment advice would benefit workers in making their investment decisions. However, this advice should be provided by a truly independent adviser as we have previously stated.[4] Unfortunately, Sections 408(b)(14) and 408(g) of ERISA as enacted do not meet this goal. And, to make matters worse, the class exemption proposed by the Department essentially allows the inadequate statutory requirements to be ignored.

The importance of strong, meaningful regulatory safeguards to avoid conflicts of interest is most recently highlighted by the ongoing crisis and near collapse of our financial system. What the crisis demonstrates is that without strong regulation, financial institutions and their employees will act according to internal institutional and personal incentives, including the receipt of additional fees and compensation. As a result, they entered into transactions involving more risk. These institutions, like employee pension plans, owed fiduciary duties to their stakeholders, but despite those responsibilities and for their own interests, they chose risky transactions that ultimately threatened the national financial system.

The Department's proposal could expose trillions of participant dollars and the retirement security of millions of workers and their families to unnecessary and inappropriate risk by allowing financial institutions with obvious conflicts, as well as their employees, to provide investment advice.

We provide some comments on the proposed regulations and suggest the Department withdraw the proposed class exemption as detailed below. Should the Department decide not to withdraw the exemption, we request that a hearing on the proposed exemption be scheduled as required by law.

<u>Proposed Regulation</u>

In the proposed regulation, the Department inappropriately limits the scope of fee leveling requirement to the fiduciary adviser and "any employee, agent or registered representative that provides investment advice on behalf of a fiduciary adviser …." Proposed 29

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[4] Our views were expressed during consideration of PPA as well as in our response to the 401(k) Plan Investment Request for Information issued by the Department. *See* 71 Fed. Reg. 70429 et. Seq.

CFR § 2550.408(g)-1(c)(iii) and (iv). The Department's narrow interpretation of Section 408(g) of ERISA excludes affiliates from the level fee requirement.[5] As a result, incentives to recommend options that provide greater benefits to an affiliate of the investment adviser will continue under the proposal. These incentives include more than just fees or other compensation. One of the most important risks participants face is the likelihood that conflicted investment advice will steer them toward products that are high margin for the fiduciary adviser or affiliates but are not appropriate for the participant. The exclusion of affiliates from the fee-leveling arrangement leaves participants exposed to potentially adverse outcomes because the existing incentives for fiduciary advisers to recommend investment options that generate greater profitability are not changed.

The proposed regulation includes a model notice to use in order to comply with the disclosure requirements in Proposed paragraph (g). Under paragraph (g)(2), the required notification "... must be written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant ...." 73 Fed. Reg. at 49921.

The model notice included in the Appendix to the proposed regulation does not meet the Department's own test and must be rewritten. For example, the second paragraph of the section titled "Compensation of Fiduciary Advisor and Related Parties" directs the participant to a section of the Code of Federal Regulations in order to learn the meaning of "a material affiliation or material contractual relationship."

The notification that a participant can arrange for advice from an independent adviser must be clearly and separately stated, rather than buried in the middle of one of the final paragraphs of the model notice.

In addition, the disclosure provided to participants should include information about the profitability of the various investment options under the plan. Providing this information will give participants some ability to protect themselves from the possibility of being steered into higher margin products.

Proposed Class Exemption

The expansive provisions included in the proposed class exemption create alternatives for "fiduciary advisers" to use, alternatives not contemplated by the statute. In our view, the proposed class exemption ignores the already inadequate requirements of the statutory exemption and should be withdrawn as it is not in the interest of participants and does not adequately protect their rights as required by Section 408(a) of ERISA.

First, the proposed class exemption, unlike the statutory exemption in ERISA Section 408(g), permits individualized advice to be given after computer model recommendations are generated with virtually no restrictions to avoid potential conflicts of interest. The

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[5] An even broader exclusion from the level fee arrangement applies in the proposed class exemption. *See* infra at p. 4.

recommendations resulting from the computer model are relegated to providing "... a context for assessing and evaluating the individualized investment advice ...." 73 Fed. Reg. at 49925.

Second, in providing individualized advice, advisers may recommend investment options that generate greater income for the fiduciary adviser, its employees and its affiliates than other plan options of the same class if they "prudently conclude" the recommendations are in the participant's best interest and explain their conclusions. *See* Section III, paragraph (e)(3) (73 Fed. Reg. at 49930).

Third, the written basis for the recommendations, including an explanation for recommending options that provide greater income to the advisers, its employees or affiliates, may be given up to 30 days after the investment advice is provided. *See* Section III, paragraph (e)(4) (73 Fed. Reg. at 49930).

Lastly, the proposed exemption restricts the level fee requirement to the particular employee, agent or registered representative providing the advice. *See* Section III, paragraph (f) (73 Fed. Reg. at 44930).

The relaxed requirements in the proposed class exemption are an invitation for advisers to take advantage, a potential recognized by the Department itself.[6] In light of the national financial crisis, now is not the time to propose an exemption that goes well beyond the statutory compromise reached just two years ago in the Pension Protection Act.[7]

We also note that the Department has failed to afford the opportunity for a public hearing on the proposed class exemption as required under Section 408(a) of ERISA. That section provides, in relevant part:

> The Secretary may not grant an exemption ... from section 406(b) unless he affords an opportunity for a hearing and makes a determination on the record with respect to the findings required by paragraphs (1), (2) and (3) ....

By its terms, the proposed class exemption provides relief under ERISA Section 406(b) (Proposed Section I), and the Department must schedule a hearing. Instead of scheduling a hearing, the proposal provides that the exemption would become effective 90 days after publication of the final class exemption. 73 Fed. Reg. 49929.

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[6] In the Regulatory Impact Analysis section of the proposed regulation, the Department acknowledges there are "... substantial risks attendant to opportunities for self-dealing that may exist among fiduciary advisers doing business pursuant to the PPA or [the] proposed class exemption. There is evidence that advisers sometimes seize such opportunities and thereby reap profit at investors' expense." 73 Fed. Reg. 49910.

[7] For other reasons, the Department itself considered, but rejected, deferring the issuance of the proposed exemption. 73 Fed. Reg. at 49911-49912.

Should the Department determine not to withdraw the proposed class exemption, as we have urged, a hearing, with adequate advance notice, should be scheduled and we request an opportunity to present our views at that hearing.

We hope our comments are helpful to the Department. Should there be any questions about them or if any additional information from the AFL-CIO would be helpful, please do not hesitate to contact me at (202) 637-3907.

Sincerely,

Thea Lee
Policy Director